

VAT brief – Takaful

1 August 2017, Kingdom of Bahrain



Following on from the release of the GCC VAT framework, Saudi Arabia's General Authority of Zakat and Tax (GAZT) has released a draft version of the law as well as a bilingual version of its VAT implementing regulations. All businesses must now be actively preparing for VAT - 1 January 2018 is less than 100 working days away.

What is VAT?

- VAT is a tax on consumption, not income or profits.
 - The GCC countries have agreed a standard VAT rate of five percent.
 - Goods and services can be exempt, zero-rated or standard-rated.
 - Registered suppliers will add VAT to the price of a good or service they supply, collect the tax and pay it to the tax authority on a regular basis.
 - Registered businesses should (where the supplies they make are either standard or zero-rated) be able to recover the VAT they have incurred in the course of making those supplies.
 - Registered businesses that make supplies that are exempt from VAT will not be able to recover the VAT they have incurred in the course of making those supplies.
 - Registered businesses that make supplies that are zero-rated will usually be in a refundable position.
- Fee-based services such as surrender, partial withdrawal or re-instatement fees, are to be standard rated.
 - Reinsurance is a common practice in the *takaful* industry with *takaful* operators purchasing re-*takaful* contracts. The applicable VAT rate may change depending on the place of the underlying risk, the place of the *takaful* operator and the place of the *takaful* reinsurer.
 - Output VAT on facultative reinsurance contracts and treaty contracts may differ.
 - The apportionment of input tax credits may be required if general *takaful* has any investment elements (such as investment-type riders) as part of the policy.
 - Exemptions increase costs to *takaful* operators as they will be unable to recover VAT paid on exempt supplies.
 - *Takaful* operators will want to maximise the recovery of input tax credits, requiring them to carefully consider all their purchases of goods and services and determine how best to minimise input VAT they cannot claim.
 - *Takaful* operators may ultimately decide to increase the costs they charge their customers – but will need to be wary of regulatory constraints and the impact on their competitive advantage.
 - Transitional issues will arise when *takaful* plans purchased or renewed before the VAT implementation date (1 January 2108 for Saudi Arabia and the UAE) if its coverage period straddles that date. *Takaful* operators may be required to charge VAT on the insurance premium. If the *takaful* operator is unable to pass on the VAT liability to policyholders, this reduce revenues.

How will VAT affect the *takaful* sector?

- Generally, conventional insurance is based on a risk transfer mechanism whereby the risk is transferred from the policyholder to the insurance company and often contains element of uncertainty. *Takaful* is based on forming a common pool of fund, making "conditional donations" – *tabarru* - and investing in *riba*-free instruments.
- From a VAT perspective, conventional insurance and *takaful* are treated the same.
- Based on GZAT's draft VAT implementing regulations, general *takaful* will be taxable at standard rate, whereas family *takaful* plans are exempted from VAT.

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What still needs to be clarified?

- Will there be any deemed input tax credit on cash settlements made by *takaful* operators for their business-to-customer insurance business?
- How will self-billing arrangements apply to reinsurance contracts?
- How will insurance contracts underwritten outside the country but provided to a local policyholder (in other words, the insurance policy is supplied by an overseas insurer with a branch in the country) be taxed?

Important note

These briefs are based on a translation of Saudi Arabia's draft VAT laws and general VAT principles and are provided for information purposes only. This document is not a substitute for professional advice. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.

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